DEPARTMENT OF STATE REVENUE

18-20130319.LOF

Letter of Findings Number: 18-20130319
Financial Institutions Tax
For Tax Years 2001-10

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.

ISSUE

I. Financial Institutions Tax–Imposition.

Authority: Mason Metals Co., Inc. v. Indiana Dep't of State Revenue, 590 N.E.2d 672 (Ind. Tax Ct. 1992); IC § 6-5.5-1-17; IC § 6-5.5-2-3; IC § 6-5.5-3-1; IC § 6-5.5-4-5; IC § 6-8.1-5-1; 45 IAC 17-2-1; 45 IAC 17-2-4; Black's Law Dictionary (6th ed. 1990).

Taxpayer protests the assessment of financial institutions tax.

STATEMENT OF FACTS

Taxpayer is a business incorporated in another state. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had never paid Indiana Financial Institutions Tax ("FIT"), but that it had been conducting the business of a financial institution. The Department therefore issued proposed assessments for FIT for the tax years, 2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, and 2010, plus penalty and interest for each year. Taxpayer protests the imposition of FIT, stating that it does not have nexus with Indiana and has never conducted the business of a financial institution in Indiana. Therefore, Taxpayer protests, it is not subject to Indiana FIT. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as necessary.

I. Financial Institutions Tax–Imposition.

DISCUSSION

Taxpayer protests the imposition of FIT for the tax years 2001-10. Taxpayer states that it had entered into a factoring arrangement with its parent company ("Parent") and that, while Parent had nexus with Indiana, it did not have nexus with Indiana. The Department based its determination that Taxpayer was conducting the business of a financial institution in Indiana on the basis that Taxpayer purchased accounts receivable from Parent via a factoring agreement and that Taxpayer's purchase and servicing of those accounts receivable constituted the conduction of the business of a financial institution in Indiana. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

In the audit process, the Department reviewed Taxpayer's credit agreements and factoring agreements with Parent and determined that the two parties were clearly involved in the factoring of extensions of credit. Taxpayer states that the function of a contract or agreement is controlling rather than the use of certain words or phrases in such a contract or agreement when determining any resulting legal and tax implications thereof.

The Indiana Tax Court has also addressed this issue in Mason Metals Company, Inc. v. Ind. Dep't of State Revenue, 590 N.E.2d 672 (Ind. Tax Ct. 1992), where it provided:

> Although the language of Mason's lease agreements purports to give Mason the right to direct the manner of the tractor's use, the evidence shows Mason actually had no such right. The tractor's drivers were employees of American, and American directed the drivers' actions. Mason also had no control over the routes taken by the drivers in getting to their destinations. Moreover, the tractor was not used exclusively to haul Mason's products. Accordingly, Mason did not have the possession and control of the tractor, under either the Indianapolis Transit test or under 45 I.A.C. 2.2-4-27(d)(3), necessary to characterize its transactions as a leasing of property subject to sales and use tax.
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> Id at 676.

Therefore, the Department must look to the function of the transactions between Taxpayer and Parent in order to determine the FIT implications of those transactions.

The Department refers to IC § 6-5.5-3-1, which states:

> For the purposes of this article, a taxpayer is transacting business within Indiana in a taxable year only if the taxpayer:
>
> (1) maintains an office in Indiana;
>
> (2) has an employee, representative, or independent contractor conducting business in Indiana;
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> (3) regularly sells products or services of any kind or nature to customers in Indiana that receive the product or service in Indiana;
>
> (4) regularly solicits business from potential customers in Indiana;
>
> (5) regularly performs services outside Indiana that are consumed within Indiana;
>
> (6) regularly engages in transactions with customers in Indiana that involve intangible property, including

loans, but not property described in section 8(5) of this chapter, and result in receipts flowing to the taxpayer from within Indiana;
(7) owns or leases tangible personal or real property located in Indiana; or
(8) regularly solicits and receives deposits from customers in Indiana.

(Emphasis added.)

The next relevant statute is IC § 6-5.5-1-17(a), which states:

"Taxpayer" means a corporation that is transacting the business of a financial institution in Indiana, including any of the following:
(1) A holding company.
(2) A regulated financial corporation.
(3) A subsidiary of a holding company or regulated financial corporation.
(4) Any other corporation organized under the laws of the United States, this state, another taxing jurisdiction, or a foreign government that is carrying on the business of a financial institution.

Next, IC § 6-5.5-2-3 states:

For a taxpayer that is not filing a combined return, the taxpayer's apportioned income consists of the taxpayer's adjusted gross income for that year multiplied by the quotient of:
(1) the taxpayer's total receipts attributable to transacting business in Indiana, as determined under IC 6-5.5-4; divided by
(2) the taxpayer's total receipts from transacting business in all taxing jurisdictions, as determined under IC 6-5.5-4.

Next, the Department refers to 45 IAC 17-2-1, which states:

(a) The Financial Institutions Tax (FIT) is intended to tax both traditional financial institutions (such as banks and savings and loans, etc.), that are transacting business within Indiana, as well as other types of businesses that are deemed to be transacting the business of a financial institution in Indiana.
(b) The FIT is a franchise tax imposed upon a corporation that:
(1) is transacting the business of a financial institution in Indiana;
(2) is a partner in a partnership that is transacting the business of a financial institution in Indiana; or
(3) is the grantor and beneficiary of a trust that is transacting the business of a financial institution in Indiana.

(Emphasis added.)

Additionally, the Department refers to IC § 6-5.5-4-5, which states:

Interest income and other receipts from consumer loans not secured by real or tangible personal property must be attributed to Indiana if the loan is made to a resident of Indiana, whether at a place of business, by a traveling loan officer, by mail, by telephone, or by other electronic means.

Finally, the Department refers to 45 IAC 17-2-4, which states:

(a) The tax is also imposed upon any corporation if the corporation is organized under the laws of the United States, this state, another taxing jurisdiction, or a foreign government and the corporation is carrying on the business of a financial institution within Indiana.
(b) The corporation is deemed to be conducting the business of a financial institution and therefore subject to the FIT if eighty percent (80 [percent]) or more of the corporation's gross income during the taxable year is derived from the following activities:
(1) Extending credit. (Refer to subsection (e) below.)
(2) Leasing that is the economic equivalent of extending credit.
(3) Credit card operations.
(c) As used in this section, "gross income" includes the income derived from activities which are performed by corporations primarily (as defined by the eighty percent (80 [percent]) test) engaged in the business of extending credit. Gross income includes income from the following:
(1) Interest.
(2) Fees.
(3) Penalties.
(4) A market discount or other type of discount.
(5) Rental income.
(6) The gain on a sale of intangible or other property evidencing a loan or extension of credit.
(7) Dividends or other income received as a means of furthering any of the three (3) activities listed in subsection (b).
(d) Extraordinary income is excluded from gross income for purposes of satisfying the eighty percent (80 [percent]) test. Extraordinary income includes income which is unusual, infrequent, nonrecurring, and unrelated to the extension of credit.
(e) For purposes of satisfying the eighty percent (80 [percent]) test, corporations which are in the business of a financial institution must be conducting the activities of extending credit, leasing that is the economic equivalent of the extension of credit, or credit card operations, as follows:

(1) Making, acquiring, selling, or servicing loans or extensions of credit. For the purpose of this subdivision, loans and extensions of credit include secured or unsecured consumer loans; installment obligations; mortgage or other secured loans on real estate or tangible personal property; credit card loans; secured and unsecured commercial loans of any type; letters of credit and acceptance of drafts; loans arising in factoring; and any other transactions with a comparable economic effect. The following are examples of extending credit:

(A) A corporation is a manufacturer of widgets. In 19x9, the corporation received one million dollars ($1,000,000) in gross income from the sale of widgets. In selling such widgets, the corporation makes available an installment obligation plan whereby its customers buy widgets over an extended period of time. In 19x9, the corporation received one hundred thousand dollars ($100,000) in interest and fees from such installment obligations. Because only ten percent (10 [percent]) of the corporation's total receipts from all sources is derived from extending credit, the corporation is not considered a taxpayer for purposes of the FIT.

(B) Corporation A is primarily engaged in the business of a collection agency. Various other corporations enter into contracts with Corporation A for purposes of having delinquent loan monies collected. Corporation A does not originate or acquire the loans. Corporation A receives income from the various corporations based upon the percentage of payments collected. Corporation A is not a taxpayer for purposes of the FIT. Although one hundred percent (100 [percent]) of Corporation A's income is from servicing loans, Corporation A is not extending credit.

(2) Leasing or acting as an agent, broker, or advisor, in connection with leasing real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes. If the lease is the economic equivalent of the extension of credit, and the lease is not treated as a lease for federal income tax purposes, the income derived from the lease is included in gross income for purposes of satisfying the eighty percent (80 [percent]) test whether the corporation is leasing its own real or personal property or is the lessor of real or personal property owned by another.

(3) Operating a credit card, debit card, charge card, or similar business. If eighty percent (80 [percent]) of a corporation's total gross income is derived from:

(A) extending credit;

(B) leasing; or

(C) credit card operations;

the corporation is subject to the FIT.

(Emphasis added.)

In reaching its determination, the Department considered the items which Taxpayer purchased from the parent company to be loans or extensions of credit which the parent had made to its customers. Therefore, the Department considered Taxpayer to be conducting the business of a financial institution as described in 45 IAC 17-2-4(e).

Of relevance here, "Receivable" is defined in Black's Law Dictionary 1268 (6th ed. 1990) as:

That which is due and owing a person or company (e.g. account receivable). In bookkeeping, the name of an account which reflects a debt due.

Next, Black's defines "Loan" in relevant part as:

A lending. Delivery by one party to and receipt by another party of a sum of money upon agreement, express or implied, to repay it with or without interest. Anything furnished for temporary use to a person at his request, on condition that it shall be returned, or its equivalent in kind, with or without compensation for its use. Bailment without reward, consisting of the delivery of an article by the owner to another person, to be used by the latter gratuitously, and returned, either in specie or in kind. A borrowing of money or other personal property by a person who promises to return it.

"Loan" includes: (1) the creation of debt by the lender's payment of or agreement to pay money to the debtor or to a third party for the account of the debtor; (2) the creation of debt by a credit to an account with the lender upon which the debtor is entitled to draw immediately; (3) the creation of debt pursuant to a lender credit card or similar arrangement; and (4) the forbearance of debt arising from a loan.

Id. at 936. Emphasis in original. Internal citations omitted.

Also, Black's defines "Commercial loan" as:

Loans made to businesses, as distinguished from personal-consumer loans. The direct loan from a bank to a business customer for the purpose of providing funds needed by the customer in is business.

Id. at 271. Internal citations omitted.

Finally, Black's defines "Consumer credit transaction" as:

Credit offered or extended to a natural person, in which the money, property, or service which is the subject of the transaction is primarily for personal, family, household, or agricultural purposes and for which either a finance charge is or may be imposed or which, pursuant to an agreement, is or may be payable in more than four installments. "Consumer loan" is one type of "consumer credit".

Id. at 316-17. Emphasis added.

Here, Taxpayer has provided sufficient documentation to establish that it purchased "accounts receivable," as defined in Black's. A straightforward account receivable is clearly different from a loan. An account receivable involves routine payment for a purchase within a set number of days, while a loan involves the return of something, either money or property, from the lendee to the lender with or without interest. In the instant case, nothing is being returned. As provided by Black's, a consumer loan is or may be payable in more than four installments. Rather, Parent sold the right to collect payment from Parent's customer's purchases to Taxpayer and Parent's customers are paying Taxpayer for their purchases.

Also, it was logical for the Department to read the factoring agreement and credit agreement and to come to the conclusion that Taxpayer was extending credit. However, as provided by Mason Metals, the function of the transactions must be reviewed to determine the actual circumstances of those transactions. There is no evidence in the protest file which indicates that Taxpayer was extending any kind of credit or loans or that it was purchasing accounts which were extensions of credit or loans. Purchasing and collecting on an account receivable is not among those activities constituting the activities of a financial institution, as defined in 45 IAC 17-2-4. Since Taxpayer was not conducting the business of a financial institution in Indiana, it is not subject to Indiana financial institutions tax. Therefore, Taxpayer has met its burden under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is sustained.

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